MP 5

U.S. Small Business Administration
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Business Development Publication
MP 5
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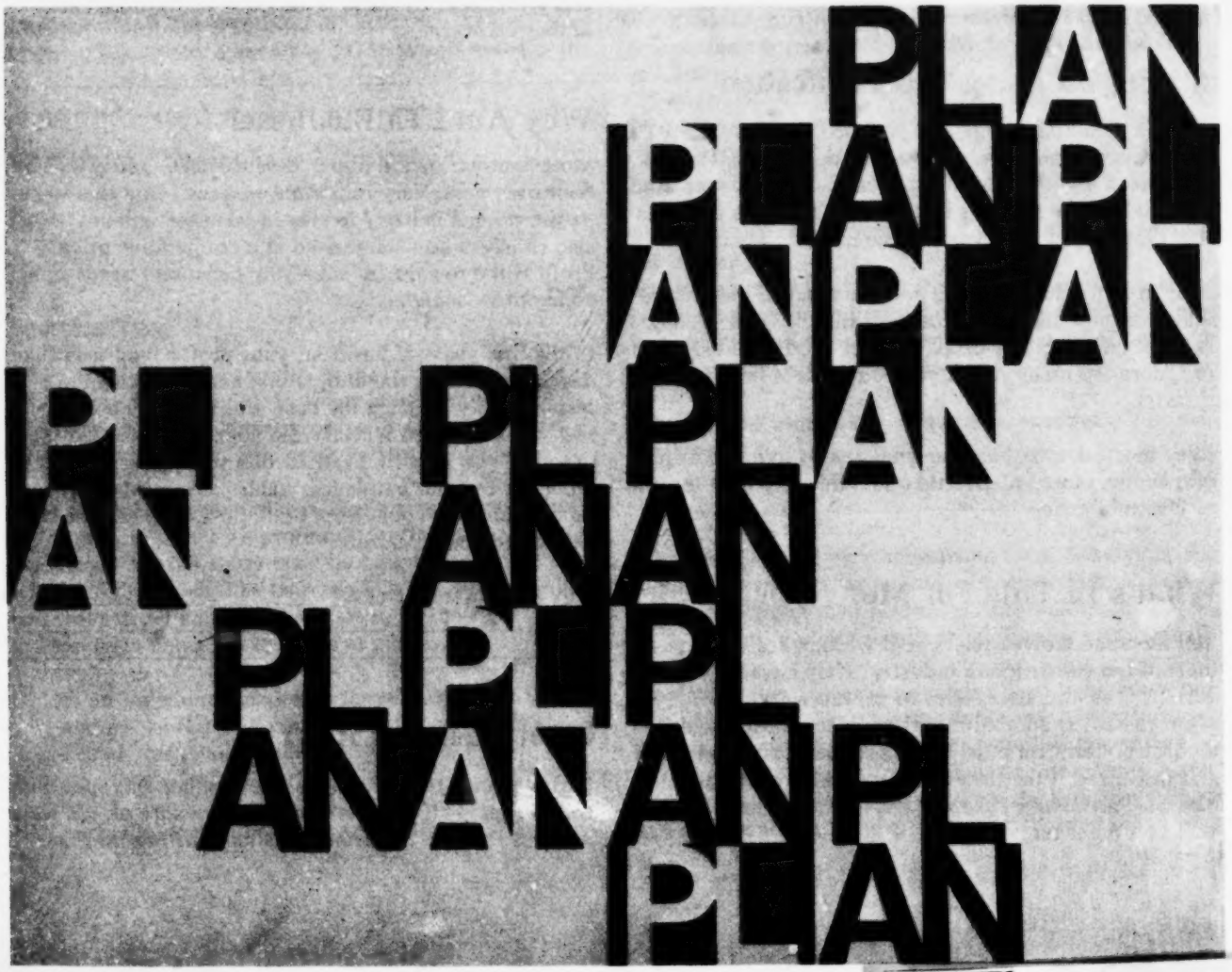
SBA

Business Plan for Small Construction Firms



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Summary

A business plan can provide the owner-manager or prospective owner-manager of a small construction firm with a pathway to profit. This publication is designed to help an owner-manager in drawing up a business plan.

In building a pathway to profit you need to consider the following questions: What business am I in? What do I sell? Where is my market? Who will buy? Who is my competition? What is my sales strategy? How much money is needed to operate my firm? How will I get the work done? What management controls are needed? How can they be carried out? When should I revise my plan? Where can I go for help?

No one can answer such questions for you. As the owner-manager you have to answer them and draw up your business plan. The pages of this publication are a combination of text and workspaces so you can write in the information you gather in developing your business plan—a logical progression from a commonsense starting point to a commonsense ending point.

A Note On Using This Publication

It takes time and energy and patience to draw up a satisfactory business plan. Use this publication to get your ideas and the supporting facts down on paper. And, above all, make changes in your plan on these pages as that plan unfolds and you see the need for changes.

Bear in mind that anything you leave out of the picture will create an additional cost, or drain on your money, when it unexpectedly crops up later on. If you leave out or ignore too many items, your business is headed for disaster.

Keep in mind, too, that your final goal is to put your plan into action. More will be said about this step near the end of this publication.

What's In This For Me?

The hammer, trowel, pliers, and wrench are well known tools of the construction industry. They have their various uses and are needed to get the work done. Management is another tool that the owner-manager of a construction firm must use. Each job must be planned and organized if the firm is to run smoothly and efficiently. The business plan will help you increase your skill as a manager.

Because of the diversification in the construction industry, you may be engaged in residential, commercial, or industrial construction. You may be either a general or specialty contractor. But, the same basic managerial skills are needed. This plan will serve as a guide to the various areas that you as a manager will be concerned with. As you work through this plan, adapt it to your own particular needs.

When complete, your business plan will help guide your daily business activities. When you know where you want to go, it is easier to plan what you must do to get there. Also, the business plan can serve as a communications device which will orient key employees, suppliers, bankers, and whoever else needs to know about your goals and your operations.

Whether you are just thinking about starting your own firm or have already started, the business plan can help you. As your skill as a manager increases so will the number of jobs you can effectively control. The careful completion of this plan may point out your limitations. This is important. To be a successful contractor you must not only know your business thoroughly, but must also know your limitations and seek professional advice in these areas.

Why Am I In Business?

Most contractors are in business to make money and be their own boss. Very important reasons. But, don't forget, no one is likely to stay in business unless you also satisfy a consumer need at a competitive price. Profit is the reward for satisfying consumer needs in a competitive economy.

In the first years of business, your profits may seem like a small return for the long hours, hard work, and responsibility of being the boss. But there are other rewards associated with having your own business. For example, you may find satisfaction in helping to put groceries on your employees' tables. Or, maybe your satisfaction will come from building a business you can pass on to your children.

Why are you in business? _____

_____

_____

What Business Am I In?

At first glance this may seem like a rather silly question. You may say, "If there is one thing I'm sure of, it's what business I'm in." But wait. Let's look further into the

question. Suppose you say, "I build houses." Are you a speculative or custom builder? Are you a remodeler? Are you a subcontractor? Can you schedule a complete job and make money? By planning according to this decision, you should realize the value of this type of thinking in dollars.

Consider this example. Bob Rogers* started a small construction business shortly after World War II. Because of Mr. Rogers' skill and talent for design, he directed all his activity toward building taverns. There was enough call for this type of building to keep him and his crew busy until the early 60's. Then sales began to fall off.

By moving his shop to smaller quarter with less overhead and by laying off half his crew, he was able to maintain his business to his satisfaction the rest of his life. After his death, his son examined the situation and decided that he wasn't really in the business of building commercial bars. He was in the business of custom finishing.

Today his business is prospering. He is building cabinets and small bars for private homes. His company also does other finishing work which requires the craftsmanship his crew is capable of.
In the space below, state what business you're really in.

_____

_____

What are your reasons for this opinion? _____

_____

_____

Marketing

When you have decided what sort of construction business you're really in, you have made your first marketing decision. Now, in order to sell your service or product, you must face other marketing decisions.

Your marketing objective is to find enough jobs at the right times to provide a *profitable continuity* for your business. Your job starts must be coordinated to eliminate the down time between jobs. In other words, you want to get enough jobs, starting at the right times, to keep from being broke between jobs.

Unless an individual can come up with enough ideas to keep a crew working 12 months a year, maybe he or she is not ready for a construction business.

*All names in our publications are fictitious.

Where Is Your Market?
Describe your market area in terms of customer profile (age, school needs, income, and so on) and geography. For example, if you are a custom builder, you may decide to build homes in the $80,000 to $130,000 price range. This would mean that your customers will have to have incomes in the middle to upper-middle class ranges. You may also decide that you can profitable build these homes on the owner's lot if it is located within a radius of 30 miles from your office. (The significance of a customer profile is that it will help you narrow your advertising to those media that will reach the potential customer you have profiled.) In the space below describe your market in terms of customer profile and geography.

My Product	Types of Customers	Location of Customers
_____	_____	_____
_____	_____	_____

Now that you have described what you want in terms of customer and location, what is it about your operation that will make these people want to buy your service? For instance, quality work, competitive prices, guaranteed completion dates, effective advertising, unique design, and so on.

Write your answer here. _____

_____

_____

Advertising
You have determined what it is you're marketing, who is going to buy it, and why they're going to buy it. Now you have to decide on the best way to tell your prospective customers about your product.

What should your advertising tell prospective customers? _____

_____

_____

What form should your advertising take? Ask the local media (newspapers, radio and television stations, and printers of direct mail pieces) for information about their services and the results they offer for your money.

How you spend advertising money is your decision, but don't fall into the trap that snares many advertisers. As one consultant describes this pitfall: It is amazing the way many business managers consider themselves experts on advertising copy and media selection without any experience in these areas.

The following workblock should be useful in determining what advertising is needed to sell your construction service.

Form of Advertising	Size of Audience	Frequency of Use		Cost of A single ad		Estimated Cost
_____	_____	_____	x $	_____	= $	_____
_____	_____	_____	x $	_____	= $	_____
_____	_____	_____	x $	_____	= $	_____
_____	_____	_____	x $	_____	= $	_____
				Total $		_____

Competition

The competition in the construction industry often results in low profit margins. However, if you are just starting or are a relatively small firm, this does not put you at a disadvantage. The smaller firm can often compete with the bigger outfit because of lower overhead expense. For example, your office may be in your home, saving that expense. You can often work right out of your truck, saving the expense of a field office.

Competition is largely price competition, although a good reputation for quality and efficiency is beneficial. But, the result of any competition is a high failure rate for poor planners and poor performers. This points out the need for careful planning, particulary in the areas of estimating and bidding.

In order to see what you are up against competition-wise, answer the following questions so you can plan accordingly.

Who will be your major competitors? _____

_____

How will you compete against them? _____

_____

Sales Strategy

The market for the construction industry is unique in many ways. As a contractor you will find your market to be dependent on such variables as the state of the economy, local employment stability, the seasonality of the work, labor relations, good subcontractors and interest rates. Also, as a contractor, you will find that you are unavoidably dependent on others, such as customers or financing institutions for payment, and other contractors for performance of their work. You will also want to take your cash flow into consideration when you estimate and bid on a job. The money must come in time to meet your own obligations.

Estimating

Whether an owner-manager in the construction business succeeds—makes a profit or not—depends to a great extent on bidding practices. Therefore, you must make careful and complete estimates.

Many of the more successful contractors attribute their success to their estimating procedures. They build the job on paper before they submit a bid. In doing this, they break the job down into work units and pieces of material. Then, they assign a cost to each item. The total of these costs will be the direct construction cost. You must also figure on the indirect costs of a job. For instance, you will have overhead expenses such as the cost of maintaining your office, trucks, license fees, and so on. The estimate should also consider any interest charges you will pay on money you borrow to get the job under way. You have insurance fees to pay, surety bond premiums, travel expenses, advertising costs, office salaries, lawyer's fees, and so on. These must also be paid out of your gross income.

Trade associations, as one of their services, often provide their members with a package of business forms. The cost estimate form would be included in this package. The obvious advantage in using these forms is that they are specifically designed for the particular trade.

Regardless of what estimate form you use, it should include such headings as "activity," "material," "labor," "subcontracts," and "estimated cost." And it should have areas for direct construction costs, indirect construction costs, overhead, and profit.

In addition, a column for the actual cost compared to the estimated cost of a specific work item will make this form an invaluable record. Here you would have a handy reference to evaluate the profitability of a job after it is complete. It would show you where your estimate was high or low, and enable you to adjust future bids on similar projects. This added column will also be necessary when it comes time for your financial accounting.

Bidding

Your decision to bid or not to bid on a particular job should be determined by several factors. First, do you have the capacity to complete the job on schedule and according to specifications. Beware of overextending yourself out of business. You have to operate within your known capabilities. On any job, you must follow all the details of the work yourself, or find competent supervision.

Bonding

The practice of bonding has been a traditional way of life for anyone engaged in contract construction. Bonding companies provide bonds for a certain percentage of the contract price. There are three main types of bonds:

(1) Bid bonds assure that the bidder is prepared to perform the work according to the terms of the contract if successful in the bid.

(2) Performance bonds assure completion of the job according to plans and specifications.

(3) Payment bonds assure anyone dealing with the bonded contractor that they will be paid.

The effect that bonding companies have had on contractors is evident in the area of competition. The customer, by requiring that the contractor is bonded, is more or less assured of adequate completion of the job. Therefore, contractors are compared on a basis of price. Also, banks are often more lenient to bonded contractors.

Bonding companies usually require the contractor to have proven experience and the organizational financial capacity to complete the project. This can be a real stumbing block to the new construction firm.

With the widespread use of bonding requirements, the competition that is generated often leads the inexperienced contractor to submit bids that are unrealistically low. One or two such mistakes often can spell bankruptcy.

Will you need bonding _____ often, _____ occasionally, _____ seldom?

Where will you get your bond?_____

_____

What will the terms be? _____

_____

The Small Business Administration has a surety bond program designed to help small and emerging contractors who might have previously been unable to get bonding. SBA is authorized to guarantee up to 90 percent of losses incurred under bid, payment, or performance bonds on contracts up to $500,000. Application for this assistance is available from any SBA field office.

Planning the Work

When your marketing efforts result in jobs to be done, the problem becomes one of production. How will you plan the work so that the job gets done on time?

No matter how you plan the work, your plan should assist you in two specific ways: (1) it should help you maintain your production schedule, and (2) it should allow you to adjust production to meet changed conditions, such as bad weather.

In planning the work, keep in mind two things: (1) the timing of starts, and (2) the timing of the various steps in the construction of your company. If you have sufficient help and sufficient supervisory personnel, it will be possible for you to engage in as many projects as you can *control*. The size and nature of the job must be considered here also.

The timing of the steps of constructions (the work scheduling) will show the various operations in sequence and assign a working day designation to each with a space for the calendar day designation. Several operations may be in progress simultaneously. Such a work schedule will show at a glance whether the work is progressing at the right time. Many companies offer commercial scheduling boards designed for this purpose.

Below is a partial work schedule to demonstrate how yours may be set up. Note that there is a column that can be filled in with either a solid mark or an "X" to indicate either partial or completed work. When you look at a particular calendar day, an "X" next to it would indicate that you're on schedule. An open square indicates a delay. Here, then, is a convenient way to see trouble spots that are causing delays and it gives you an opportunity to take corrective action.

Working Day

Activity	*Start*	*Finish*	*Calendar Day*	*Complete*
1. Layout	1	1	15	☒
2. Foundation Forms	1	2	16	☒
3. Foundation Pour	3	3	19	◪

(indicates ¾ complete)

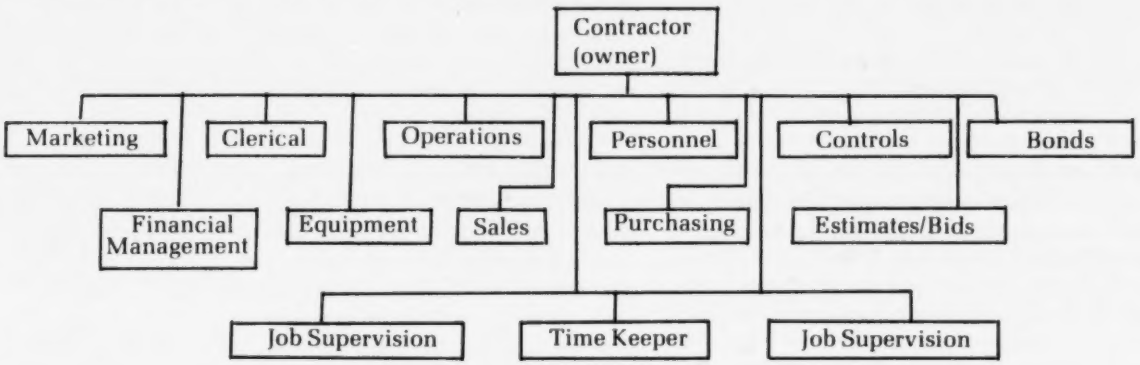
You should save your work schedules. They will form the basis for future estimates. For example, if you are estimating a particular job, you have information on the steps of production, an indication of what materials you'll need and when you'll need them, an indication of how long the job will take, and any peculiarities that may affect the completion of the job. When you consider all these things, you'll be more likely to submit an accurate bid.

By carefully keeping such records, you will also have an indication of how many workers you will need. Perhaps, if the work falls behind schedule, you may need to bring more workers to the job to assure scheduled completion and avoid a possibly larger financial loss from penalization, if that is called for in your contract. Also, such records will give you an indication of the organizational structure you may need for your firm.

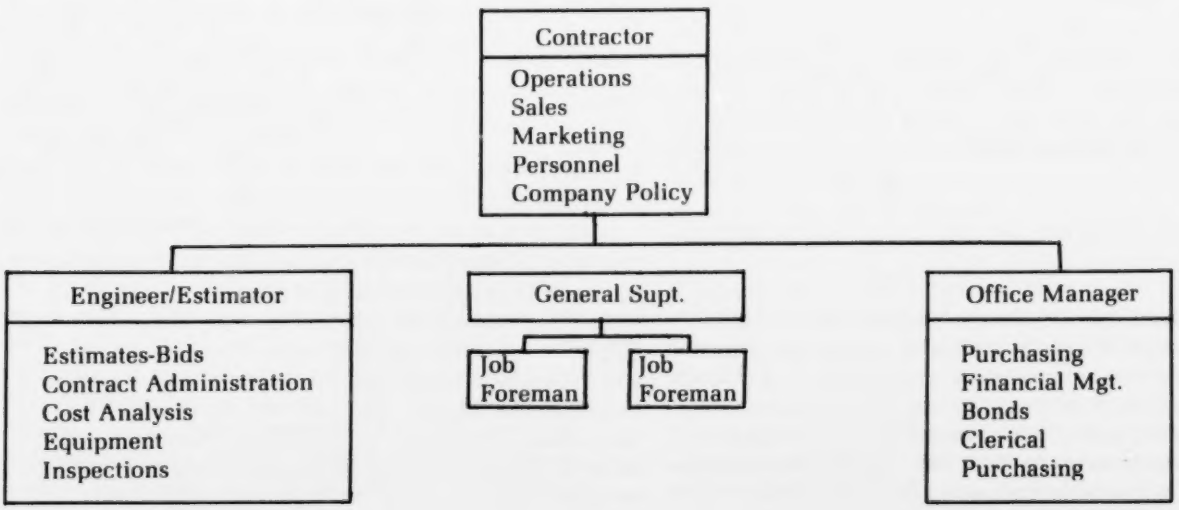
Getting the Work Done

If your firm is going to run efficiently, you will need organization. Organization is essential because as your company grows you will not be able to do all the work. You have to delegate work, responsibility, and authority. The organization chart is a useful device in getting this done. It shows quite clearly who is responsible for the major activities of your business.

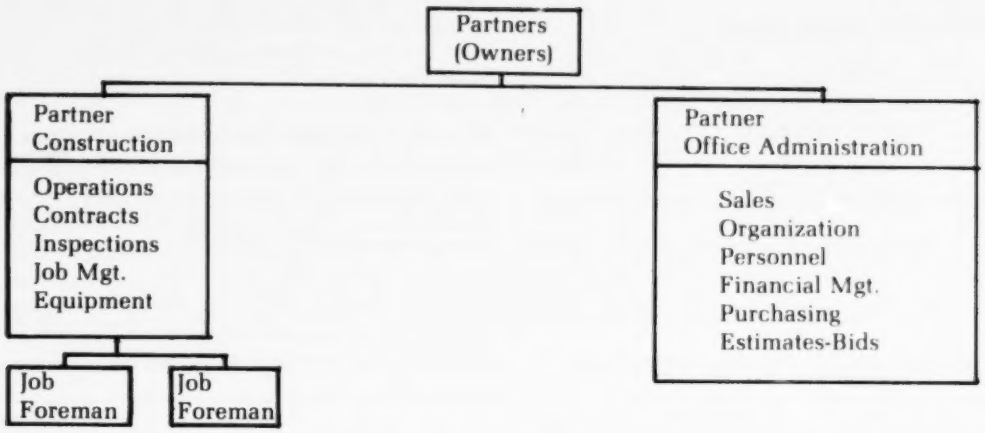
At first, many construction companies are one man shows. It is up to the owner to do almost everything. In this case the organization chart might look something like this:



As the company grows, perhaps specialists are added, such as an engineer/estimator, an office manager, and a general superintendent. The organization chart then begins to look something like this:



Often, people with complementary experience and skills, such as work experience and office experience will form a partnership. The organization chart will look like this:



Draw an organization chart for your company.

What are Your Personnel Requirements?

Will you carry a permanent crew or hire workers as the need arises? _____

Will you use union or nonunion labor? _____

How many workers will you need? _____

What is the hourly rate you will pay? _____

What will fringe benefits cost? _____

Will you supervise the work yourself or hire a foreman?

If you hire a foreman, what will this salary be? _____

Will you need clerical help? _____ What will it cost? _____

_____

Equipment

What special equipment will you need (assuming that your work force will supply their own hand tools)?

Equipment	Rent	Buy	Your Cost
_____	_____	_____	$ _____
_____	_____	_____	$ _____
_____	_____	_____	$ _____
_____	_____	_____	$ _____
_____	_____	_____	$ _____

Will you need an office or use your home? _____

_____

If you will need an office, what will the rent and other expenses cost? _____

_____

_____

_____

_____

Put Your Plan Into Dollars

Just as with the other aspects of managing a construction business, the basic unit of financial management is the job. The financial aspects of a job must be planned as carefully as the actual construction. The payment for each job must cover the direct and indirect construction costs as well as the allocated share of overhead.

Accounting requirements will vary from company to company and from trade to trade. Your accountant will help you set up the accounting system which will best meet your needs.

However, you must make the overall plans yourself. You must develop the goals necessary to guide and manage your business. This overview will prove invaluable in establishing a good working relationship with your banker (or other lender) and bonding company.

In your financial planning, the first consideration is where the dollars will come from. In dollars, how much business (sales) will you be able to do in the next 12 months? $ _____

Expenses

In connection with annual sales volume, you need to think about expenses. For example, if you plan to do $100,000 worth of work, how much will it cost you to do this amount of business? And even more important, what will be left over as profit at the end of the year?

Profit is your pay. Even if you pay yourself a salary for living expenses, your business must make a profit if it is to continue year after year and pay back the money and time you invest in it. Profit helps your firm to be strong—to have a financial reserve for any lean periods.

The "Expenses Worksheet" is designed to help you figure your yearly expenses. To use this worksheet, you need to get one set of figures—the operating ratios for your line of business. If you don't have these figures, check with the trade association which serves your area of the construction industry.

Matching Money and Expenses

After you have planned for your month to month expenses, the next question is: Will there be enough money coming in to meet these expenses and to sustain your company in the event that there is down time until your next job?

The cash forecast is a management tool which can eliminate much of the anxiety that can plague you during lean month. Use the worksheet "Estimated Cash Forecast," or ask your accountant to use it, to estimate

the amounts of cash that you expect to flow through your business during the next 12 months.

Remember that the expenses of buying the materials and supplies for a particular job may occur a month or two before a payment is made. The "Estimated Cash Forecast" should show this.

Estimated Cash Forecast	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
Expected Available Cash												
Cash Balance												
Expected Receipts												
Job A												
Job B												
Job C												
Bank Loans												
Total Expected Cash												
Expected Cash Requirements												
Job A												
Job B												
Job C												
Equipment Payments												
Taxes												
Insurance (including surety bond payments)												
Overhead												
Loan Repayments												
Total Cash Required												
Cash Balance												
Total Loans Due to Bank												

Expenses Worksheet

Sample Figures for Specialty Contractors*	% of Your Sales	Your Annual Sales Dollar	Your Dollars Jan	Your Dollars Feb	Your Dollars Mar	Your Dollars Apr	Your Dollars May	Your Dollars Jun	Your Dollars Jul	Your Dollars Aug	Your Dollars Sep	Your Dollars Oct	Your Dollars Nov	Your Dollars Dec
Sales	100.00%													
Cost of Sales	44.45													
Gross Profit	55.55													
Controllable expenses														
Outside labor	1.15													
Operating supplies	2.34													
Gross wages	22.78													
Repairs and maintenance	.59													
Advertising	1.12													
Car and delivery	2.04													
Bad debts	.03													
Administrative and legal	.48													
Miscellaneous expenses	1.03													
Total controllable expenses	31.56													
Fixed expenses	1.00													
Rent	1.41													
Utilities	1.16													
Insurance	.85													
Taxes and licenses	.10													
Depreciation	1.65													
Total fixed expenses	6.18													
Total expenses	37.74													
Net profit (before income tax)	17.81													

*These percentages are taken from *Barometer of Small Business*, Accounting Corporation of America. These figures are presented *only as a sample* and refer to specialty contractors with an annual gross volume between $50,000 and $200,000. The percentages vary from one business to another.

Is Additional Money Needed?

In your planning you may find periods when you will be short of cash. For example, when you start a job you will need materials and supplies. Perhaps it may be a month or two before your first payment. What do you do in the interim if trade credit will not completely satisfy your cash needs?

Your bank may be able to help with a short term loan. If a banker is to lend you money on either a short or long term, he or she will want to know whether your company's financial condition is weak or strong. The bank officer will ask to see a balance sheet.

A blank balance sheet is included. Even if you don't need to borrow, use it. Or, have your accountant use it to draw the "picture" of your firm's financial condition. Moreover, if you don't need to borrow money, you may want to show your plan to the bank that handles your company's account. It is never too early to build good relations with your banker. For the time may come when you will have to borrow.

Current Balance Sheet
for
(name of your firm)

as of _____
(date)

Assets

Current Assets	$_____
Cash	$_____
Receivables	$_____
Cost of jobs in progress	$_____
Inventories of supplies and tools	$_____
Total Current Assets	$_____
Fixed Assets	$_____
Other Assets	$_____
Total Assets	$_____

Liabilities

Current Liabilities	
Notes payable	$_____
Accounts payable	$_____
Miscellaneous current liabilities	$_____
Total Current Liabilities	$_____
Equipment Contracts	$_____
Owner's equity	$_____
Total Liabilities	$_____

Control and Feedback

To make your plan work you will need feedback at the various stages of your management process. When you approach a job as a manager, you will need to plan the job, direct the job, and control the job. Throughout this process, you will need adequate financing. Thus, the management controls you set up should supply you with the information you need to keep your operation "on the money."

During the planning stage, you will need to carefully calculate your bid estimate. To direct the job, you will need your job cost analysis to make sure that the job is going to make a profit. And, to control the job, your forces must be organized. This requires the organized production of any given job (work schedule), competent personnel, and your personal follow-up to insure efficient performance.

Is Your Plan Workable?

Now that you've planned this far, step back and take a look at your plan. It is realistic? Can you do enough business to make a living.

Now is the time to revise your plan if it isn't workable, not after you've invested your time and money. If you feel that some revisions are needed before you start your own business, then make them. Go back to the cash flow and adjust the figures. Better, show your plan to someone who has not had a hand in making out your business plan. Your banker, contact man at SBA, or any outside advisor may be able to point out your strong points which if emphasized could turn into dollars.

If you have strong doubts about your business or your ability to run it, it might be better to delay going into business until you feel as comfortable with the tools of management as you are with the tools of your trade.

Keeping Your Plan Up To Date

How many people in this world can predict the future? Very few indeed! You can expect things to change. You can expect circumstances to be different from what you expected. This is only natural. The difference between successful and unsuccessful planning is often only the ability to keep alert and watch for changes. Stay on top of changing conditions and adjust your plan accordingly.

In order to adjust your plan to account for changes, an owner-manager must:

1. Be alert to the changes that come about in your industry, your market, and in your customers.

2. Check your plan against these changes.

3. Determine what revisions, if any, are needed in your plan.

Whatever methods you use to keep up with changing conditions is up to you. Once a month or so, go over your plan. See whether it needs adjusting. If revisions are needed, make then and put them into action.

Put Your Plan Into Action

When your plan is as near on target as possible, you are ready to put it into action. Keep in mind that action is the difference between a plan and a dream. If a plan is not acted upon, it is of no more value than a pleasant dream that evaporates over the breakfast coffee.

The first action step would be acquiring enough capital to get started. Do you already have the money? Will you borrow it from friends, relatives, or a bank? Where and when will you hire competent employees?

What else needs to be done? Look for positive action steps that will get your business rolling. For example, where and how will you get whatever licenses you need to be a contractor? (These requirements differ from state to state. A summary of licensing, prequalification, and tax information may be found in *Summary of State Regulation and Taxes Affecting General Contractors*, published annually by the American Insurance Association.)

In the following space, list the things that you must do to get your business off the drawing board and into action. Give each item a date so that it can be done at the right time.

Action	*Completion Date*

We hope this publication has met your business needs. For a free copy of the Directory of Business Development Publications, write to: Publications, P.O. Box 1000, Fort Worth, Texas 76119 or contact your local SBA office.

SBA has a number of other programs and services available. They include training and educational programs, advisory services, financial programs, and contract assistance. Our offices are located throughout the country. For the one nearest you, consult the telephone directory under U.S. Government or call the Small Business Answer Desk at 1-800-368-5855. In Washington, D.C., call 653-7561.

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